factsheet

HOUSING OPTIONS

Discretionary Trusts and Tax (*ref 21*)

Discretionary Trusts - What for and When?

To provide for a disabled son or daughter either in your lifetime or on your death. They may need some extra money now or it could be a way of providing a home to live in. When you die you want to pass on your wealth to family members for their future security but for a disabled family member you may want to provide for their future now.

Entitlement to Income Support

If a person with a learning disability is named as a potential beneficiary of a discretionary trust and might therefore receive a payment of income or capital from the trust, this will not in itself affect his/her entitlement to income support or local authority funding for care. In addition, if income or capital is paid out for specifics not paid for by statutory funding, the payments made will also not be taken into account. So if a disabled family member depends on benefits don't just pass on money or property directly - use a trust.

Created in Your Will or in Your Lifetime

A Trust is a formal transfer of assets (property, shares or just cash) to a number of persons (at least two and not more than four) or to a Trust Company with instructions that they hold the assets for the benefit of others. If a Trust is made in your lifetime, so that it takes immediate effect, it can be created by a Trust Deed. If it is to be created after your death, then the trust rules can be set out in your Will.

There is no minimum or maximum amount of money that you can place in trust, but obviously the amount of the trust fund will need to be enough to make sure that running the trust is financially viable.

A Discretionary Trust

A discretionary trust is the most flexible form of trust. Under a discretionary trust, the benefits, the trust assets or the income from them, are allocated entirely at the trustees' discretion to anyone or more of several beneficiaries or class of beneficiaries eg disabled people.

It is recommended that a 'Letter of Wishes' is written for the Trustees to outline your wishes as to how the trust fund should be spent, but this is a moral rather than a legal obligation on their part. You are usually advised to name more than one person and/or organisation as a beneficiary so as to avoid the trust being classed as a 'sham'.

Tax on Setting Up
There are taxation consequences on the setting up and running of a discretionary trust, and you need to discuss these with your solicitor before you proceed. However, as a guide, if you set up a discretionary trust with under £285,000, there will be no inheritance tax to pay on set up. The limit for a husband and wife settlement is £285,000 each. Over £285,000 (current rate) in your lifetime, pays 20% inheritance tax on setting up the trust; If you put cash into the trust when you set it up, there will be no capital gains tax to pay; however if you put assets into the trust (such as shares or a property) then there may be capital gains to pay on transferring the assets into the trust. The trust is set up for a period of say 80 years and on the death of the principal beneficiary the trust may continue and no inheritance tax is payable. On winding up funds or capital must be distributed to eligible beneficiaries - other family members, disabled people or charities as provided for in the trust or Letter of Wishes.

10 Yearly Charges, Capital Gains Tax and Income Tax
There are also ten-yearly inheritance tax charges on the anniversary of the trust paid currently at 6% of the value over the £285,000 limit. During the life of the trust, tax on income and capital gains arising in the trust is paid at 40%. None of the beneficiaries are classed as having an absolute Interest in thetrust and if they are on Income Support tax paid may be recoverable.

A Disabled Trust
A disabled trust (or 'trust for the vulnerable') is a special form of discretionary trust in compliance with s.89 Inheritance Tax Act 1984.

A number of beneficiaries are named but the disabled person would be named as the principal beneficiary of the trust. A condition is that at least half of the money paid out must go to them.

Special tax treatment of trusts for 'vulnerable beneficiaries' allows for the trustees and vulnerable person to make an election for the special tax treatment to apply in relation to both income and capital gains tax - as if the vulnerable beneficiary owned the trust assets themselves.

But, after the principal beneficiary's death, the principal beneficiary will be treated as having an interest in possession in the trust for inheritance tax purposes, even though the trust is discretionary in form - this means that on their death, their estate will include the value of the trust fund on their death.

Which is Better?
The Disabled Trust is often recommended as a tax efficient way of passing income to someone eg from an accident claims settlement or where there is only one child to be provided for but it is more restricted in operation and is liable to Inheritance Tax on the death of the prime beneficiary.

The broader Discretionary Trust does not have some of the tax advantages of the Disabled Trust but is free of Inheritance Tax on the death of the main beneficiary and can more easily provide for other family members.

Get advice from Solicitors with experience of wills and trusts for the benefit of someone with a learning disability. Mencap 020 74540454 have their own in house solicitor and will provide a list for your area. They also organise free seminars across the country provided by a local solicitor.

If you require further information or have other queries contact Housing Options.

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